



State Investment Commission

Monthly Meeting Minutes

Wednesday, March 27, 2013

9:00 a.m.

Room 135, State House

The Monthly Meeting of the State Investment Commission (SIC) was called to order at 9:03 a.m., Wednesday, March 27, 2013 in Room 135, State House.

I. Roll Call of Members

The following members were present: Ms. Rosemary Booth Gallogly, Mr. J Michael Costello, Mr. Thomas Fay, Mr. Robert Giudici, Ms. Paula McNamara, Ms. Marcia Reback, Mr. Andrew Reilly, General Treasurer Gina Raimondo and Mr. Frank Karpinski.

Also in attendance: Mr. Thomas Lynch of Cliffwater, alternative investment consultant to the Commission; Mr. Alan Emkin, Mr. John Burns and Ms. Lindsey Sugar of Pension Consulting Alliance (PCA), general policy and real estate consultant; Ms. Sally Dowling, of Adler Pollock, legal counsel; Mr. George Gilmer and Mr. Mark Sullivan of BNY Mellon; Mr. Stewart Kohl and Ms. Peggy Roberts of Riverside Capital; Ms. Anne-Marie Fink, chief investment officer and members of the Treasurer's staff. Treasurer Raimondo called the meeting to order at 9:03 a.m. Mr. Giudici left at 10:20.

II. Approval of Minutes

On a motion by Mr. Costello and seconded by Ms. Booth Gallogly, it was unanimously **VOTED: To approve the draft of the minutes of the February 27, 2013 meeting of the State Investment Commission.**

III. Riverside Capital Recommendation

Mr. Lynch described Riverside as a private equity firm targeting lower mid-level companies in the U.S. He introduced Mr. Kohl and Ms. Roberts.

Mr. Kohl explained they target growth business which can be acquired for less than \$200M and with which Riverside can work to make them two to three times bigger through organic growth and add on acquisitions. He briefly described Riverside's history.

He pointed out Riverside is big investors in their own fund which creates aligned interests. For background, Mr. Kohl explained separate fund strategies at Riverside including a European, microcap and developed Asia funds.

Mr. Kohl explained their office locations and the structure and experience of their staff. He then described, in detail, their realization and performance history.

Ms. Roberts highlighted one of their acquired companies and provided a detailed case study of their full process from acquisition to sale.

The committee asked some questions and Riverside left the room.

Mr. Lynch explained that to maintain the plan's allocation in private equity the committee needs to make about \$150M in commitments this year. He said the private equity portfolio

needs more buyout strategies with smaller companies and Riverside fits that criterion. He then recommended the board commit \$20M to the Riverside.

On a motion by Mr. Costello and seconded by Ms. Reback, it was unanimously

VOTED: to commit \$20 million to Riverside Capital, for investment in Riverside Capital Appreciation Fund VI predicated on satisfactory completion of all due diligence.

IV. Claren Road Recommendation

Mr. Lynch reminded the board of the whole hedge fund portfolio and of the SIC's decision to redeem two managers. He explained they need one more manager to bring the real return portfolio back to full allocation.

Mr. Lynch then recommended Claren Road as a replacement for Gracie. He described their team, the firm's history and their investment strategy. He explained since inception they have an annualized rate of return of 9.9% with a 4% level of volatility and a Sharpe ratio of 1.90. He then took the board through their operational due diligence and recommended investment in Claren Road to replace Gracie. He initially considered recommending a \$40M commitment, but then explained the institutional share class has lower fees, but a longer initial lockup. He pointed out, with the low volatility and size of the firm the lockup for the lower fees is a good tradeoff. The minimum of the institutional share class is \$50 million. Mr. Lynch said Cliffwater asked Claren Road to waive the additional \$10M commitment to enter the institutional share class, but Claren was not able to. Given that, Cliffwater recommends committing \$50M to the Claren Road institutional share class to attain the lower management fee.

Ms. Booth Gallogly asked if Claren Road was considered during the initial funding process and Mr. Lynch said yes. Ms. Fink pointed out they are currently closed, so they only replace capital when someone redeems the equivalent amount. Mr. Lynch pointed out 55% of Claren Road is owned by Carlyle, which provides them large institutional support, but Carlyle is hands-off in terms of investment and business strategy.

Ms. Booth Gallogly asked about regulatory protections and Mr. Lynch explained they are SEC registered as an investment advisor and their disclosure is excellent, but this has no effect on the terms of the initial lockup commitment.

Ms. Fink said Claren Road is a lower volatility, low risk manager with many focused technical disciplines to control risk. She said it is a big stable organization and Claren Road's credit approach is a nice balance to other areas of the portfolio. For these reasons she is inclined to invest in the institutional share class for the lower management fee.

Mr. Lynch reiterated that from Cliffwater's perspective Claren Road is one of the best fund managers in the credit space.

On a motion by Ms. Reback and seconded by Mr. Fay, it was unanimously

VOTED: to commit \$50 million to the Claren Road Institutional Share Class predicated on satisfactory completion of all due diligence.

V. Real Estate Recommendations

Ms. Sugar gave a brief update on the secondary sale process. PCA has received offers with varying values from six bidders and they have narrowed it down to select bidders for final round bids due mid-April. Because this is an ongoing process Ms. Sugar is not inclined to

discuss values to ensure it remains a competitive process for best pricing. They are pricing the next round of bidding at 4th quarter numbers instead of 3rd which are more favorable.

Ms. Fink said the process is going well, but we would like to go back to the original bidders to ensure the best pricing. She explained the assets might be sold at a discount, but the price levels should make it worthwhile for us to sell at a discount and redeploy the money in a better investment vehicle, rather than wait for these investments to run their cycle.

Ms. Sugar pointed out the bids are in line with expectations when this process was started and values also came up. The board then discussed if they should wait to sell and it was determined they should not because they are both buyers and sellers and for a variety of other reasons.

Ms. Sugar continued to discuss PCA's recommendation to allocate up to an additional \$25M in AEW's Core Property Trust Fund. She explained the plan's history and current investment with AEW. She then reviewed AEW's investment fundamentals and plans for calling capital. She said they are calling capital soon and this would be a way to put additional real estate investments into the market very soon.

Ms. Fink and Ms. Sugar took the board through the rebalancing timeline to get the real estate portfolio to full policy allocation.

Ms. Sugar explained since ERSRI was one of the first investors in AEW's Core Property Trust Fund they have reduced ERSRI's legacy management fee by 50 basis points.

Ms. Sugar then recommended allocating up to an additional \$10M to Heitman.

The committee then reviewed the secondary sale process.

On a motion by Mr. Costello and seconded by Mr. Giudici, it was unanimously

VOTED: to commit an additional \$25 million to AEW predicated on satisfactory completion of all due diligence.

On a motion by Mr. Fay and seconded by Mr. Giudici, it was unanimously

VOTED: to commit an additional \$10 million to Heitman predicated on satisfactory completion of all due diligence.

VI. OPEB Asset Allocation

Treasurer Raimondo reminded the committee they voted last month to recommend to the OPEB Board to switch the OPEB asset allocation from 65% in fixed income to 35% in equity to 65% equity and 35% fixed income. She explained this decision was made because of the concern around fixed income rate risk and the OPEB plan has better cash flows than the pension plan. She explained Ms. Fink and Mr. Mark Dingley, Treasury staffer, went to the board and made this recommendation and the OPEB board explained they wanted to mirror the pension fund's asset allocation. Ms. Fink explained staff started looking into the logistics of potentially making this switch. She explained the four separately managed accounts, State employees, Municipal employees, state police and judges all have the same tax ID and because OPEB plan has a separate tax ID, some investment managers need to form a separately managed account to manage the additional OPEB assets. She explained it then becomes a challenge to meet minimum AUM thresholds for managers. The committee then discussed the complications of this issue and discussed legacy complications as well. The committee discussed the possibility of having the OPEB board apply for the same tax ID.

Given these issues, the vote on OPEB asset allocation did not occur, but the committee agreed to go back to the OPEB board, explain the complications and strongly recommend they act on the SIC's recommendation from the last OPEB meeting to allocate 65% to equity and 35% to fixed income while staff looks into the logistics of possibly commingling the assets.

VII. AllianceBernstein Amendment

Ms. Fink referenced an amendment to part of the AllianceBernstein contract. She explained this amendment relates to the principal protected income option within the CollegeBound fund. She said this is a low risk stable value fund in the lineup and about 10% of assets are in it nationally and 12% in the Rhode Island plan. She explained AllianceBernstein assures the assets in this option never go down by using the assets to provide safe securities at relatively low duration. Ms. Fink said they also buy derivatives to buy protection as well as an insurance wrap to ensure the value of the asset never goes down. She said ING is their insurance provider. She said this amendment addresses derivatives and she said the fund has always been able to use derivatives, but the language wasn't completely clear. Ms. Fink said when AllianceBernstein goes to market to buy derivatives there are certain counterparties which would like to see the language in the contract. She pointed out, adding this language will allow AllianceBernstein to access more of the market. She then discussed the changes in section 5 that were made during the staff's legal review process.

On a motion by Mr. Costello and seconded by Mr. Fay, it was unanimously
VOTED: to approve the AllianceBernstein amendment.

VIII. Corporate Governance

Ms. Fink said staff has been spending a lot of time exploring different corporate governance options. She reminded the board of Ann Yerger's presentation from the Council of Institutional Investors.

Ms. Fink explained there has been a lot done by funds like CALPERS, where they have more assets, a bigger staff and own assets directly. She explained ERSRI is different because it currently only invests in commingled funds. She pointed out ERSRI never technically has the right to vote, but it still has the obligation to oversee those who vote on the plan's behalf.

Ms. Fink said this structure allows the board to focus on the ultimate goal of generating value on the asset being voted on. Looking for feedback from the board, Ms. Fink outlined the corporate governance policy and her four principles for long-term value creation. The four principles are board accountability for shareholders, board effectiveness and decision making, creating long-term value and transparency.

Mr. Costello asked about State Street Global and pointed out they can't dictate who is in the index. Ms. Fink said State Street has to vote proxies and Treasury staff began a dialogue with them already.

Ms. Reback asked for the policy to be clear enough where it is easy to determine which issue fits in which principle bucket and the board discussed the mechanics of this concern.

IX. Legal Counsel Report

Ms. Dowling gave an update on the legal agreements she and Treasury staff are working on.

X. CIO Report

Ms. Fink reviewed performance for last month and reviewed each asset class and some individual managers. She pointed out the private equity and real estate number is on a quarterly reporting lag, so it is not a particularly useful number.

Ms. Fink said WAMCO received \$200M and has invested about three quarters of that to-date and will probably be fully invested next week. She said using leverage with PIMCO was explored in depth and staff decided to proceed without leverage at this time. She said PIMCO should be funded sometime next week. She explained how each manager would be funded.

Ms. Fink explained the infrastructure RFI is an ongoing process and explained out of caution she has recused herself because her former employer submitted a response. She said PCA and staff have narrowed thirty-two submissions to a short-list of eight. She explained the process is ongoing.

Treasurer Raimondo explained she has inserted herself in the process because Anne-Marie is not able to participate and she believes if the search does not surface the right managers, the board should not put all the money to work. The board agreed.

Ms. Fink updated the board on the CollegeBound Fund and explained part of the contract provides the SIC with funds to hire a consultant. Ms. Fink plans to hire a consultant to focus on the investment lineup. She believes our existing general consultant is qualified to do the assessment and Mr. Emkin pointed out they consult for eight states on their 529 plans. The board agreed.

Ms. Fink updated the board on the banking rfp and the move of the disbursement account to Sovereign.

Ms. Fink updated the board on the Valic stable value floor issue. She explained the participants received a better deal because they grandfathered in participants who joined the plan before April 1, 2013 at a 3% floor.

XI. Treasurer's Report

Treasurer Raimondo said staff is continuing to monitor the one gun holding in the portfolio. The board discussed selling its L.P. interest in the fund.

XII. Adjournment

There being no other business to come before the Board, on a motion by Mr. Fay and seconded by Mr. Reilly, the meeting adjourned at 11:01 a.m.

Respectfully submitted,



Gina M. Raimondo
General Treasurer